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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 127

FEDERAL POWER COMMISSION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

No. 128

MEMPHIS LIGHT, GAS AND WATER DIVISION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR UNITED GAS PIPE LINE COMPANY

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October 20, 1966

FIDELITY PRINTING COMPANY, INC., HOUSTON

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR UNITED GAS PIPE LINE COMPANY[1]

[1] In this brief, reference will be made as follows: Federal Power Commission, FPC; Memphis Light, Gas and Water Division, Memphis; United Gas Pipe Line Company, United; Union Producing Company, an affiliate of United, Union; United Overseas Production Corporation, an affiliate of United, Overseas; United Gas Corporation, parent of United, Union and Overseas, Corporation; Natural Gas Act, Act; R will refer to the printed record in this Court, thus R I 4 cites Vol. 1 of the Record at page 4, etc.; CR will refer to the Certified Record but not brought forward in the printed Record in this Court; reference to Petitioners' Briefs, i. e., FPC 2 or Memphis 2, will refer to FPC Brief, page 2, etc. All emphasis is supplied unless the contrary be noted.

COUNTER-QUESTION PRESENTED

Where a group of affiliated corporations, including United, files a consolidated Federal income tax return reflecting oil tax deductions and losses of United's affiliates, Union and Overseas, arising from non-utility operations which are not subject to the jurisdiction of the FPC, are wholly unrelated to the operations of United, and are not reflected in United's cost of service:

May the FPC utilize such oil tax deductions and losses to reduce the Federal income tax component includible in United's cost of service on which United's rates for the sale of gas, regulated under the Act, are based?

STATUTES INVOLVED

In addition to those listed by FPC, the following: § 1(b) of the Act; from the Internal Revenue Code of 1954, (26 USC 1 et seq): § 11(a), (b), (c); § 172(a), (b), (c); § 1503 (c)(1)(A), (B); and the following Regulations,[2] 26 CFR: § 1.1502-15(a); § 1.1502-30(a); § 1.1502-31(a)(1), (b)(1), (2); § 1.1502-34(a), (b), (d); and § 1.1502-35 — set forth in Appendix A.

COUNTER-STATEMENT

FPC Opinion 428 (R II 32), involved increased rates filed by United under § 4(d) of the Act. In computing Federal income tax component in United's cost of service, the FPC substituted for the applicable statutory corporate tax rate, a lower so-called "consolidated effective tax rate"

[2] On September 8, 1966, retroactive to January 1, 1966, changes in some regulations became effective. Citations in this brief will be made to the regulations applicable to the pertinent period involved here.

attributable to United's joinder with its affiliates in a consolidated Federal income tax return filed by their parent, Corporation.

This computed "consolidated effective tax rate" of 50.04% used by FPC instead of the statutory 52% rate, gives United's jurisdictional *gas* customers the benefit of tax deductions and losses which are not United's but which belong to Union and Overseas, and arise solely from the latters' *oil* operations, (App. D; R II 24), over which everyone agrees the FPC has no statutory control.

Pursuant to § 19(b) of the Act (15 USC 717r(b)), United petitioned the Fifth Circuit to set aside Opinion 428 and Opinions 428-A and 428-B on rehearing. The FPC approved a settlement, 32 FPC 1515, which removed all issues save that of the consolidated tax (R II 57).

Background. United, its parent, Corporation, and Union, another subsidiary of Corporation, filed consolidated tax returns during the FPC's "representative period" (1957-1961), being joined in 1961 by a third subsidiary, Overseas (R I 24, 37, 40).

Corporation owns all the outstanding stock and long-term indebtedness of its three subsidiaries, and operates natural gas distribution systems in Texas, Louisiana and Mississippi (R I 40-3). United is a natural gas transmission company purchasing, transporting and selling natural gas in intrastate and interstate commerce for resale and also for direct industrial consumption (R I 40-1). Union is in the business of exploring, developing, and operating oil and gas properties. It sells most of the natural gas it

produces to United (R I 40-2).[3] Overseas operates entirely outside of the United States, being engaged in oil exploration operations in Africa (R I 41-2).

The operations of Corporation, United, Union, and Overseas are separate and distinct, and are of an entirely different nature from the operations of each of the others. (R I 39-42).

Corporation is not subject to FPC jurisdiction; but its distribution business is subject to regulation by State agencies in Mississippi, Louisiana and Texas (R I 41-3).

United's interstate sales for resale — approximately 44% of its sales (FPC 3; R II 54) — are regulated by the FPC. United's intrastate sales to town borders in Louisiana are regulated by the Louisiana Public Service Commission, those in Texas are subject to regulation by the Texas Railroad Commission, those in Mississippi by the Mississippi Public Service Commission. These intrastate sales are not regulated by the FPC. Direct sales to industrial customers generally are not regulated (R I 42-3).

Union's interstate sales of gas for resale are regulated

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[3] The FPC (FPC 4, and fn 5) says Corporation-United-Union constitute "an integrated gas utility system from well-head to consumer's premises", emphasizing that 80% of Union's gas goes to United, who in turn furnishes Corporation with 96% of its supply. This is a meaningless exaggeration.

Using the same sources FPC refers to, and its concession that this 80% is only 11% of United's supply (p 3 of its brief in the Court below), the facts are shown to be: The 80% of Union's gas sold United is 11% of United's supply. In 1964 Corporation sold a total of 95 billion cu ft. 96% of 95 billion cu ft is 91.2 billion. In 1964 United sold 1,438 billion cu ft. Thus the 91.2 billion cu ft sold by United to Corporation is 6.34% of the gas sold in 1964 by United. 11% of such 6.34%, or less than 1% of the gas sold by Union to United traveled from Union's well-heads to Corporation's burner-tips through the facilities of the three companies. The true facts destroy the picture the FPC would like to create.

by the FPC. Union's sales of oil and intrastate sales of gas, which constitute the majority of its business, are outside FPC jurisdiction, and are not regulated (R I 42, 44-5).

Every sale made by United or Union subject to FPC regulation is made under a contract or rate schedule on file with the FPC.

Income Tax Background. Unquestionably, if United filed a separate Federal income tax return as a separate entity, its tax allowance in cost of service would be computed at the statutory rate of 52%.[4] United does not lose its separate entity or the separate identity of its gas operations under the consolidated return provisions of the tax law.

Under the Internal Revenue Code (Code) (§ 1501 to 1504 (App A, FPC and United)), a consolidated return may be filed, on election, by a common parent and its subsidiaries where the parent owns 80% of all classes of voting stock, and 80% of the non-voting stock. United's group qualifies.

The tax regulations (§ 1.1502-30(a), § 1.1502-31(a), (b), App A 4-12a), preserve the separate corporate identity by defining consolidated income, on which the tax computation is made, as a *combination* of taxable incomes, computed separately, of the members of the group. Obeying these provisions, each company in United's group prepares a return on a separate basis (R I 56), and delivers it to the parent. The taxable income for each of the companies on a separate return basis for years 1957-1961 is shown at R II 5-16. Taxable income on a separate company basis after elimination of certain intercompany transactions for

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[4] The corporate statutory rate for the "representative period" here is 52%. Under the 1964 Revenue Act, the rate is 50% for 1964, and 48% for years thereafter.

consolidated return purposes, as used in Ex 36 (Revised) (R II 24) and used by the FPC in Op 428 (R II 53) for the years 1957-1961 is shown in Appendix B.

By Reg. § 1.1502-15 (App A 4a) each member joining in the consolidated return is severally liable for the total consolidated tax, even though such member might have no tax on a separate return basis.

The FPC Decision. The majority declared complete factual similarity between United's case and *Cities Service Gas Co.*, Op 396, 30 FPC 158, stating: *"The question here involved has already been determined by us in Cities Service Gas Company"*. The FPC directed application of the *Cities Service* procedure to compute United's "consolidated effective tax rate" (R II 41-2, 53; See App C).

The FPC states that this "procedure" was "recently enunciated in *Cities Service Gas Co.*, 30 FPC 158" (FPC 7) contrary to Memphis' claim that the FPC was following its "established administrative practice * * * *most* recently reflected in * * * *Cities Service* * * *" (Memphis 9). The prior FPC cases cited (Memphis 15) are said to represent this established practice, but none of these cases involve non-jurisdictional losses of affiliates. (See, App. C, 26-7c). This dichotomy of position reveals that the reaching out for non-jurisdictional losses is a new ploy requiring new and previously unpossessed powers.[5]

In their dissents, Commissioners O'Connor and Woodward concluded the 52% statutory rate should be utilized

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[5] It is new in the sense that the FPC has not previously so held. The issue, however, was before the FPC in *Olin Gas Transmission Co.* (1957) 17 FPC 685, 693-4, 703, and was decided in accordance with United's contentions, (but cf the caveat at p 696 — not deemed to affect the tax holding). To the same effect, see p 51-74 of the Examiner's decision in *Tennessee* (G-19983, dated May 28, 1962, unpublished.)

for the reasons in their dissent in *Cities Service,* which they adopted (R II 55).

Their *Cities Service* dissent stated that utilization of the consolidated effective tax rate would frustrate Congressional intent underlying the consolidated return provisions of the law; that the use of the effective tax rate theory appropriated losses which derived from expenditures in non-jurisdictional business activities financed not by the regulated gas company's customers, but rather by stockholders; that the customers of the gas company would receive a windfall while the company itself obtained no benefit from inclusion in the consolidated return; that it had the effect of regulation by the Commission of non-utility enterprises beyond the Commission's jurisdiction; that the Commission decision was based on the false premise that it had the power, which "clearly" it did not have, to amend § 1501 of the Code and to limit the effect of the mandate of Congress expressed in that section; and that the Commission's action resulted in a clear deprivation of property without due process of law in that it took away from non-utility companies included in the consolidated group valuable property rights which belong to said companies (App C, 26c-36c).

The Judgment of the Court of Appeals. In the Fifth Circuit, United asserted direct, unequivocal support for its contentions in the Tenth Circuit decision in *Cities Service Gas Co.* v. *FPC* (1964) 337 F 2d 97 (FPC App B), involving precisely the same issue before the Fifth Circuit.

The Tenth Circuit reversed and set aside the "method" devised by the FPC in *Cities Service,* which it purportedly applied to United. The Tenth Circuit held that "No 'tax savings' resulted from the inclusion of the Gas Company in the consolidated return" (FPC App B, 38); that "We think

it is legally fallacious to calculate the Gas Company's tax allowance on the basis of the consolidated tax liability of the parent company" (FPC App B, 37); and after demonstrating that "the reduction in the total tax liability effected by the consolidated returns is due to the losses of the nonregulated companies", it concluded:

> "It is thus plain that the apportionment of the total tax liability among the regulated companies fails to comply with the jurisdictional requirement for the separation of regulated and nonregulated profits and losses which Congress wrote into the Act, and which the Commission prescribed for itself. The Commission's method is therefore unauthorized and its order based thereon must be set aside." (FPC, App B, 39).

The Fifth Circuit studied this record and the Tenth Circuit decision, and concluded:

> "United would have us follow the Tenth Circuit's *Cities Service* decision. The Comission says that the *Cities Service* case is to be distinguished because of fact differences. It urges that the Tenth Circuit decision is wrong and should not be followed. We do not think there are any such fact differences between *Cities Service* and this case as call for the application of any different rule of decision. The Court in the Tenth Circuit case held that the tax allocation as made by the Commission's order was contrary to the requirements which Congress had imposed. We think the Tenth Circuit case is correct and that the principles which are announced in its opinion are here applicable and controlling. The Commission's order, using an incorrect income tax rate in computing cost of service for the fixing of United's gas rates is erroneous and must be vacated and set aside." (R II 71-2)

Thus, two Courts of Appeals are unanimous in holding the FPC orders unlawful in the jurisdictional aspects noted.

This upheld the two Commissioners who dissented in the *Cities Service* and *United* proceedings. We find no court decision to the contrary.

SUMMARY OF ARGUMENT

I.

Both in the Petition and brief, the FPC admits that its purported "allocation formula" does transfer the entirety of the "tax losses" which the FPC equates to "tax savings", from *non-jurisdictional unregulated* activities to the *regulated* members of the consolidated group, i.e., United and Corporation. This confesses the jurisdictional "transgression" which the Court below adjudged to result from the FPC failure to separate, as the Act requires, the regulated from the non-regulated profits and losses. It necessarily follows that the judgment below was right.

To rescue itself, the FPC suggests that its decision might be reinstated on the basis of a "sharing of benefits" idea. But analysis of the so-called "sharing" concept demonstrates conclusively that it would itself result in the identical jurisdictional violation, as that confessed and adjudged; and that, considered against the facts and circumstances of this case, there is nothing to "share".

Such admission by the FPC, without more, warrants affirmance by this Court of the judgment of the Court below.

II.

The 52% tax rate applicable here is prescribed by statute. That rate must be applied to United's taxable income to compute the Federal income tax component in United's cost of service, to recoup which, its jurisdictional rates are set.

The "consolidated effective tax rate" of the FPC is a contrived device, without statutory sanction. Under the FPC technique, the jurisdictional customers of United receive the benefit of unrelated, non-utility, non-jurisdictional oil losses belonging not to United, but to its affiliates Union and Overseas — losses issuing from operations in which FPC exhibits neither interest nor use in aggregating United's jurisdictional rate base and cost of service for rate making purposes. Union's gas operations for the representative period had an aggregate net taxable income, so that the oil operations of Union and Overseas necessarily were the sole source of those "benefits" appropriated for United's jurisdictional customers, who contributed nothing to their existence. In so doing, the FPC, under the guise of "allocation", broke out of the jurisdictional bounds fixed by Congress in the Act, to invade and seize operations beyond its jurisdiction.

The carryback, carryforward provisions of the Code ensure that Union can utilize its own tax losses. There is, thus, no basis for any treatment of United save to compute its income tax component in its cost of service by application of the statutory corporate income tax rate to its own taxable income.

Apart from the illegality of the FPC technique, this record indisputably shows that had the FPC done what its formula purported to require, Union's and Overseas' oil tax deductions and losses would have been more than offset by unregulated taxable income, which confirms the demonstration that the FPC, as United contends and the Court below held, must and can only compute United's income tax component solely from its own separate taxable income times the statutory tax rate.

The Court below, following the path of construction of

the Act laid out by this Court, correctly set aside the order complained of.

III.

Petitioners present nothing contrary to the foregoing:

A consolidated tax is not a joint cost. Thus, no "allocation" is indicated or permissible. A consolidated tax is a function of the separate taxable income of each corporation times the statutory tax rate. This separate and individual function is not disturbed, but retained by the consolidated return statutes and regulations. Thus the tax liability of United is derived from its own operations, and is a direct cost to it. The Court below properly so held.

United's customers make no contribution to Union's oil costs, as FPC and Memphis claim, for the FPC in Union's case carefully separated out all oil costs to obtain a jurisdictional cost of service for gas alone. It approved settlement rates which would recoup only that jurisdictional gas cost of service. It is these settlement rates that United pays Union.

No basis appears to support the FPC claim that the purpose of consolidated returns was to pierce the corporate veil. On the contrary, the courts hold that consolidated return provisions preserve the separate corporate entity. FPC jurisdiction does not depend on corporate form, but on the presence of those things expressly conferred to its authority by Section 1(b) of the Act.

The Memphis claim of rate increase to its customers, should the decision of the Court below be affirmed, is without any substance.

ARGUMENT

I.

The FPC Admits the Jurisdictional Violation Adjudged.

The essence of the holdings of the Fifth and Tenth Circuits is that the FPC tax "allocation" is unauthorized and unlawful for failure to comply with the jurisdictional requirement for the separation of regulated and non-regulated profits and losses which Congress wrote into the Act (R II 71-2; FPC App. B 39).

In its Petition (p 10, fn 8), the FPC concedes that its "formula * * * *may* result in allocating the *entire* tax saving resulting from *losses* of *unregulated* activities to the *regulated* members of the consolidated group." But in its brief (p 15) it advances from the timidity of "*may*" to the flat, unqualified admission that its formula "(* * * applied to the facts of this case, results in allocating the *whole* of the savings to the companies that had taxable income)" i.e., United and Corporation.

Thus the FPC confesses the jurisdictional transgression which the Court below adjudged.

The FPC seeks to retrieve by suggesting that its decision might be supported by an alleged propriety of some character of a "sharing" of the "benefits" of the non-jurisdictional tax losses. The short answer is that any "sharing," particularly as the FPC here seeks with United's jurisdictional customers, would be unlawful, for it would produce the identical jurisdictional transgression for which the Court below vacated and set aside the instant order. The second short answer is that the FPC by its own confession has appropriated "the whole" of these non-jurisdictional tax losses — leaving nothing to share.

Furthermore, as we demonstrate, see p. 20-1, *infra*), Union can utilize its own tax losses.

Finally, the FPC brief itself exposes this "sharing of benefits" idea as specious. For the FPC declares (FPC 6) that the taxable income of the parent corporation for the representative period was $9,024,170 — almost three times the aggregate of Union's and Oversea's non-jurisdictional oil tax deductions and losses of $3,894,060. Corporation, the sole investor in Union, is clearly entitled to all of the "benefits" of such losses, because of the provisions of the tax regulation governing adjustment of Corporation's tax cost basis in Union (see p 22, 32; see App A 12-7a, *infra*). Also, even if the FPC had followed its own unlawful "allocation formula", as it purported to do, the unregulated income from non-jurisdictional activities would more than have absorbed such losses (see p 31-2, fn 13, *infra*). In each and all of these events, there could be nothing to "share".

In our respectful submission, the unqualified concession by the FPC of the jurisdictional transgression which the Court below decreed, warrants, without more, affirmance of that judgment.

II.

The "Consolidated Effective Tax Rate" and Its Unlawful Impact on United. Tax rates are prescribed only by statute. There is no authority under the Internal Revenue Code prescribing or authorizing a so-called "consolidated effective tax rate." A Federal income tax results from two factors: (1) The prescribed statutory tax rate — here 52%, and (2) a properly determined amount of taxable income to which the statutory tax rate is applied. 26 USC 11. A consolidated effective tax rate is a contrived device wholly beyond statutory sanction.

Here the FPC did not even follow, as it purported to do, its illegal *Cities Service* three-step procedure (R II 41). Instead, it compounded its unlawful action by dividing the

consolidated tax between United and Corporation in the ratio of their respective taxable income to the consolidated income. Then it related the amount assigned United to United's taxable income to derive the 50.04%.[6] The 50.04% rate is a fiction — the result of a contrived device — under which United's customers improperly receive the tax benefit of deductions from sources other than United's own operations.[7] This record indisputably shows the sources of these deductions to be $3,869,626, the net loss from Union's *oil operations* (App D), and $24,354, the net loss from Overseas' *oil operations* (R II 24).

In the FPC computation of United's income tax component (R II 53), 92.11% of the consolidated tax is attributed to United since that is said to represent its average income contribution to the group over the representative period (1957-61). This is supposedly done to "allocate" actual taxes paid. But if 92.11% of the non-

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[6] This is exactly what Staff did in *Cities Service*. The FPC rejecting it as "artificial" and "instable" for rate-making, thus described it:

"In effect, Staff's effective tax rate is derived by taking the ratio Gas Company's income bore to the total income of the profit making companies, and applying this percentage to the system tax paid." (United App C, 7-8c)

[7] In Memphis' brief below at p 30 there appears Appendix A which shows that for the year 1958 all companies included in the consolidated return were in a taxable income position, and further that the "effective tax rate" for United in that year was 62.017%. The FPC's order would head off a two-way application of its formula by the stricture "that the allowance so computed for the regulated company shall not exceed what its tax liability would be for rate-making purposes, *if computed on a separate return basis.*" (i.e., 52%) 30 FPC at 164. In this event, who would bear the 10% difference?

Thus where non-jurisdictional operations of an affiliate result in a taxable profit, the FPC beats a hurried retreat to the concept of the pipeline company as a separate entity incurring a separate tax liability at the statutory rate. And thus does the FPC refuse to play ball both ways, the rules of the game depending on who benefits.

jurisdictional net tax loss from Union and Overseas is subtracted directly from United's taxable income, and this reduced figure is then multiplied by 52%, *or*, if 92.11% of this net tax loss is itself multiplied by 52%, and then subtracted directly from United's income tax computed separately at 52%, the answer in each case is the same as the amount computed by applying the so-called "consolidated effective tax rate" of 50.04% to United's taxable income of $105,290,983 adjusted by $396,875 for capital gains and surtax exemptions. Thus even casual scrutiny reveals that the FPC formula is not one to "allocate" taxes paid but one to divide up non-jurisdictional losses.

In actuality, under this device, United's jurisdictional customers receive the benefit of $380,698[8] annually, from sources other than United's own operations, i. e., the unrelated, non-jurisdictional, non-utility oil operations of companies other than United included in the consolidated return.

The FPC Order Exceeds its Jurisdiction. It is a fundamental principle recognized by this Court, that non-utility losses or deductions arising from non-jurisdictional operations must not be considered for rate-making purposes.

Thus, this Court stated in *Panhandle Eastern Pipe Line Co.* v. *FPC* (1945) 324 U S 635:

> "We agree that the Commission must make a separation of the regulated and unregulated business when it

[8] Recomputing Op 428, App 4 (R II 52), at the 52% statutory tax rate instead of 50.04% results in a $760,936 increase in overall cost of service. Allocation to classes of sales on the basis of Op 428, App 6 (R II 54), results in a $380,698 increase in jurisdictional sales. In other words, the taxable income figure used by the FPC is $380,698 less for its jurisdictional customers under the 50.04% rate than would be the case under the 52% rate.

> fixes the interstate wholesale rates of a company whose activities embrace both. Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act." (p 641-2)

The FPC may not regulate oil operations. §1(b) of the Act

Accordingly, Union's plant investment devoted to the production of oil is not included in United's rate-base upon which its return is computed, nor are Union's costs attributable directly, or by allocation, to its oil operations used to *increase* United's cost of service. This is proper. The FPC, however, would then latch on to the tax consequences of those same non-jurisdictional operations to *decrease* United's cost of service for the purpose of reducing rates to United's jurisdictional customers. This makes no sense, regulatory or common.

The FPC has a range of discretion in selecting a method for allocating costs between jurisdictional and non-jurisdictional operations. *Colorado Interstate Gas Co.* v. *FPC* (1945) 324 US 581, 589; *Panhandle Eastern Pipe Line Co.* v. *FPC, supra.* But the clear limits of that range of discretion were spelled out in *Colorado Interstate*:

> "Colorado Interstate and Canadian object to the Commission's use of the return. The Commission included in the total cost of service for these companies a 6½ per cent return on the rate base. In other words, the 6½ per cent return was computed on the basis of all the property used by petitioners in their various classes of business — intrastate sales, direct industrial sales, and interstate wholesale sales. Now it is apparent that if the reduction ordered was based on the excess of revenues from all classes of business over the aggregate costs, the result would be to reduce to a common level the profits from each class. In that case, whenever a

company was making a higher return on its unregulated business than the rate of return allowed for the regulated business, the excess earnings from the unregulated part would be appropriated to the entire business. When the unregulated business was being operated at a loss or at less than the return which was allowed, excess earnings from the regulated business would be appropriated to the unregulated business. A low rate might therefore be concealed by siphoning earnings from the unregulated business; a high rate rate might be built up by making the regulated business share the losses of the unregulated one." (p 593-4)

The clear direction set out by this Court in the *Panhandle Eastern* and *Colorado Interstate* decisions is highlighted by the analysis of a thoughful judge in terms which illuminate this particular case. See *Mississippi River Fuel Corp.* v. *FPC* (CADC 1947) 163 F 2d 433, 439. The same case (p 448) approved the FPC action on income taxes. That action evidences a recognition which the FPC could well have emulated here,

"No attempt is made to limit the return from the business which is beyond our jurisdiction. In making a cost of service study, it is necessary to determine the expenses on an over-all basis before they can be properly allocated. One of the expenses which must be calculated on an over-all basis is the income tax. The tax is determined by the taxing authorities with reference to the business as a whole and that, necessarily, must be our starting point. For the purposes of simplicity as well as accuracy of the computation, the income tax is computed at what it would have been if the return on the company's entire business were limited to 6 percent, the reasonable rate of return for the jurisdictional business. When a tax computed in this manner is allocated, automatically the amount assigned to the jurisdictional business equates to the tax which is associated with the 6 percent return on that business. It should be emphasized that the cal-

> culation is made solely for the purpose of determining the tax which applies to the regulated business. The Company by reason of higher, [or lower], earnings, may pay a much higher, [or lower], tax on its non-regulated business, but this, under the Natural Gas Act, is no concern of the Federal Power Commission." (*Mississippi River Fuel Corp.*, (1945) 4 FPC 340, 355-6)

Though the FPC recognized in this case the principle of effective separation (R II 48), it inconstantly ignored this principle in its computation of United's tax allowance. Such conduct repudiates the principle laid down by this Court in *Panhandle Eastern* and *Colorado Interstate, supra,* as was correctly appreciated by the Fifth and Tenth Circuits.

Nature of Union's Operations Requires Separation Between Jurisdictional and Non-Jurisdictional Costs and Revenues. Consistent with the basic rate-making principle that jurisdictional and non-jurisdictional costs and revenues must be separated, United contends that the tax losses and deductions arising from Union's unrelated, non-jurisdictional and non-utility oil operations, which are wholly disassociated from United's gas operations, cannot be taken into account in computing United's tax allowance in cost of service.

As noted, Union's net loss from oil operations for the period 1957-1961 was $3,869,626. This reflected $9,617,865 (R II, 17-21, col. 10, line 24) of intangible drilling costs of producing *oil* wells, without regard to the loss carry-back and carry-forward provisions of the Code, (App A, § 172), and without regard to the fact that Union has more than ample proven oil and gas reserves to insure that it could utilize all of its tax losses and deductions if it were to file separate tax returns (R I 61, 67-9, 71-2).

During the five-year period 1957-1961 Union's gas operations produced aggregate net taxable income of $507,254. (App D). Thus, Union's gas operations did not give rise to tax losses.

This leaves only Union's oil losses for FPC appropriation under the technique of the consolidated effective tax rate. After Union's gas operations are excluded, the net aggregate tax loss which the FPC would give to United's customers arises solely from Union's unrelated, non-jurisdictional, non-utility oil operations, in the amount of $4,376,880 (App D), and $24,354 from Overseas oil operations (R II 24), aggregating $4,401,234.

Union's and Overseas' oil operations are wholly outside the FPC's jurisdiction and the tax results stemming from those operations should not be reflected in United's regulated cost of service. Not only are these oil operations irrelevant to the interstate resale of natural gas; the Act, without exception, prohibits use of them by the FPC in rate determination for jurisdictional gas.

The consequent impact on United, and its jurisdictional customers, of this forbidden focus on Union's oil situation would surely be rate instability — rising or falling with Union's oil tax deductions and losses, over all of which the FPC has no control and in which such customers have no interest.

Both the FPC and Memphis place heavy reliance on *El Paso Natural Gas Co.* v. *FPC* (5 Cir. 1960) 281 F 2d 567, cert. den. 366 U S 912 (FPC 25, 27; Memphis 5, 19-20). United recognizes, as it advised the Court below, the force of *El Paso* and needs but point out that the Fifth Circuit, in holding for United, obviously found no inconsistency with *El Paso* and its position below.[9]

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[9] Indeed, one member of the panel below also sat in *El Paso*, and significantly no mention of *El Paso* is included in the decision below; nor was *El Paso* mentioned by the Tenth Circuit in *Cities Service*.

United's case is completely distinguishable from *El Paso*. First, the consolidated effective tax rate issue was not involved in *El Paso*. Second, *El Paso* did not attempt to reduce gas rates by utilizing tax losses and deductions from El Paso's *oil department* operations. On the contrary, the FPC in *El Paso* carefully separated out all *oil* and other non-utility operations — including the tax consequence thereof — thus leaving only jurisdictional *gas* operations.[10] The tax expense in *El Paso* reflected the statutory depletion and intangible drilling allowance relating solely to the *natural gas operations* of the company. The lesson of *El Paso* is clear and simple: It restricts the authority of the FPC over tax deductions to jurisdictional gas operations and business.

Union can Utilize its Own Losses. For the five-year representative period, 1957-1961, Union was in a taxable income position in its gas operations while its oil operations resulted in a loss for tax purposes. On a separate return basis, Union would have the right to carry-forward for five years and back for three years, any loss for a given year as an offset to taxable income in any of the eight years. (§ 172(b))

The eight year period affords wide latitude for a corporation to recoup its prior losses. The record in this case shows that Union, on a separate return basis, would have been able to utilize all of its tax losses, incurred during the five-year representative period, under the carry-over provisions of the Code (R I 71-2).

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[10] Memphis' equation of its one corporate entity with production department hypothesis (Memphis 19) to United-Union, with the statement that "no one for one moment would think of suggesting" disregarding tax deductions from "production operations" is forgetful of the fact that in *El Paso*, "no one for one moment" thought of *including* oil tax deductions.

Inasmuch as all of Union's tax losses, including oil as well as gas losses, could be offset against its own separate income in prior or subsequent years, there would be nothing available from the oil operations to give to United's gas customers (R I 67).

United Does not Profit from Union's Losses. The FPC's position is based upon the wholly irrelevant circumstance of a consolidated tax return. Such position could not be urged absent such consolidated return. The fallacy in the FPC's position is exposed by the fact that United's taxable income based on its allowable rate of return and its own tax deductions gives rise to a tax computed at the 52% statutory rate irrespective of whether United's taxable income is included in a separate return or a consolidated return.

The impact of the tax burden at the 52% statutory rate on United's taxable income, unreduced by Union's losses, demonstrates that United does not profit from Union's losses. No provision of the tax law or regulations governing the filing of consolidated returns and the computation of tax thereunder channels the tax effects of Union's losses to the benefit or reduction of United's tax on its own taxable income.

Under the FPC theory, there would be appropriated to United's customers the benefit of whatever results flow from the filing of a consolidated return, even though such results have their origin in losses and deductions which are wholly extraneous to United's operations. Since the FPC does not include these non-jurisdictionall costs in United's cost of service, why should the tax effect of those costs be inserted in the computation of the tax component included in United's cost of service?

United's customers have not contributed one dollar to Union's losses. The stockholders of Corporation have supplied the capital, the use of which gives rise to Union's tax losses. A tax loss does not generate profit. A loss merely affords a means of partial recoupment specified by the tax law. There is no justification either at law or in equity why the burden of the loss should be borne by the supplier of the capital while such recoupment of the loss flows to others who have assumed no risk, who have contributed no capital, and who are not entitled to any profits which ultimately may succeed the earlier losses. Not only do the stockholders assume the risk of loss on the venture itself; they pay the price the Regulations exact (Reg. 1.1502-34; 1.1502-35.)[11] See, generally, discussion in Peel, Consolidated Tax Returns § 14.02 and § 14.03, p 199-216.

The courts, the tax law and the tax regulations recognize, even if the FPC does not, the true effect of an affiliate's loss in consolidated returns. The loss is related to the parent company's investment in the affiliate. The loss does not confer any benefits or profit on any of the affiliates in the consolidated group.

On the other hand, inclusion of United in the consolidated return effects no tax saving for the consolidated tax payable is increased by exactly 52% of United's separate taxable income. This can be vividly demonstrated by using exactly the same type of schedule, which the Court in *Cities Service* employed.

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[11] This price is a pro-tanto reduction in the tax cost basis of Corporation's investment in Union measured by tax losses which Union itself could not recoup.

Year	(1) Consolidated Tax — Including United*	(2) Consolidated Tax Excluding United**	(3) United's Separate Tax at 52%***	(4) Sum of (2) plus (3)
1957	$13,560,947	$ 240,742	$13,320,205	$13,560,947
1958	16,091,376	4,352,910	11,738,466	16,091,376
1959	11,356,973	470,069	10,886,904	11,356,973
1960	8,250,373	(885,735)	9,136,108	8,250,373
1961	7,940,211	(1,721,131)	9,661,342	7,940,211
Total	$57,199,880	$ 2,456,855	$54,743,025	$57,199,880

*After adjustment for capital gains. (R II 53.)

**This amount is determined by subtracting United's taxable net income as it appears at R II 24 (as adjusted for capital gains), from the consolidated taxable net income appearing at R II 24 (as adjusted for capital gains) and multiplying the difference by 52%.

***This amount is determined by multiplying United's taxable net income (R II 24), as adjusted for capital gains (R II, 11, 15) by 52%.

The above schedule demonstrates conclusively that inclusion of United in the consolidated return, for each of the years in the five year period, increased the consolidated tax liability of the entire affiliated group by 52% of United's income included in the consolidated return — so that no "tax savings" resulted from inclusion of United in the consolidated return. This is the exact situation present in *Cities Service*.

The aggregate consolidated taxable income figure for the consolidated return group for the "representative" five year period, after adjustment for capital gains, was $110,052,655 (R II 53), of which United's portion, after adjustment for capital gains, was $105,275,049 (R II 53, II 11, II 15). The statutory tax rate throughout the period was 52%. 52% of $110,052,655 (after adjustment for surtax exemption) is $57,199,880, and 52% of $105,275,049 is $54,743,025. There can be no doubt that $57,199,880 was the tax liability on the combined taxable income of all the companies for

the five year period. Similarly, there can be no doubt that $54,743,025 of such aggregate tax was United's tax liability to the Government in respect of its own separate taxable income. This amount is the result of applying the 52% rate to United's own separate taxable income. This is no "fictitious" or "hypothetical" tax. Therefore, it is indisputable that a tax on United's own separate taxable income, (for the five-year "representative" period utilized by the Commission in seeking to impose a consolidated effective tax rate), at the rate of 52% was in fact paid.

The Tenth Circuit summarized the record before it in an identical schedule (FPC App B 38,) from which it concluded,

> "The simple fact is that the tax liability of the Gas Company as reflected in the consolidated returns was not hypothetical, but an actual cost to the Gas Company." (Id).

Memphis, calling this schedule a "mathematical exercise", seeks to demonstrate its "fallacy" by an erroneous computation based upon an incomplete assumption (Memphis 25-7).

This assumed example not only disregards the tax loss carry-forward and carry-back provisions of the Code, it disregards the vitally necessary distinction between jurisdictional and non-jurisdictional, non-utility operations, which is the issue the Court decided. Using Memphis' example, and classifying correctly the corporations between jurisdictional and non-jurisdictional in the same proportions as the United group, shows the confiscation which results from the FPC's so-called consolidated effective tax rate. United is 56% non-jurisdictional; Corporation is 100% non-jurisdictional, with the portion of its operation in gas distribution regulated by various state commissions; Union is about 50% non-jurisdictional (R II 4); and Over-

seas is 100% non-jurisdictional. Corrected, the Memphis computation is:

Corporation	Taxable Net Income (Tax Loss) Total	Jurisdictional	Non-Jurisdictional
A — United	$20,000	$ 8,800	$11,200
B — Corporation	10,000		10,000
C — Overseas	5,000		5,000
D — Union	(5,000)	(2,500)	(2,500)
Total taxable net income	$30,000	$ 6,300	$23,700
Consolidated tax liability at 52% tax rate	$15,600	$ 3,276	$12,324

Memphis wrongly accuses the Fifth and Tenth Circuits of using an invalid theory to compute a fictitious tax of $18,200. These Courts did nothing of the sort. The Federal income tax liability is *52%* of taxable net income derived from jurisdictional operations, *52%* of taxable net income derived from non-jurisdictional operations, which adds to the total amount of $15,600, not $18,200, and which equates *52%* of consolidated taxable net income.

The Fifth and Tenth Circuits did not go "astray". The actual consolidated tax liability was used to show that there could be no question but that both jurisdictional and non-jurisdictional operations resulted in taxable net income which was taxed at the statutory 52% tax rate. The Tenth Circuit also showed that the tax loss carry-back provisions of the Code permit the offsetting of tax losses in the same manner as the non-jurisdictional taxable net income and income tax at 52% are reduced by non-jurisdictional operations of Corporation D — Union in the above example.[12]

[12] Memphis' suggestion (Memphis 26) that the Court's theory utilizes a "negative tax" ignores the operation of the loss carry-forward and carry-back provisions of the Code. IT 4085, cited by Memphis, relates only to the allocation of negative tax for earnings and profits purposes.

The corrected Memphis table is illustrative of the fatal defect in the FPC application of its "method" to United. The FPC flatly states "the unregulated activities in the present case produced no taxable net income" (FPC 7), but such is not true.

United's unregulated gas sales alone produced more taxable net income than its regulated sales.[18]

The FPC decision stated that "In making a separation between the regulated and non-regulated companies, we find that United is largely a regulated company, and we shall designate it as such *for the purpose of these calculations*" (R II 41). The fact is just the opposite. United is largely a non-regulated, non-jurisdictional company, and when properly classified between regulated and non-regulated activities in accordance with the FPC Op 428, every computation and statement made by the FPC and Memphis is obviously incorrect. Such is obvious because the non-jurisdictional activities of United and the entire United group produce more net taxable income than the regulated activities and there is no tax loss from non-jurisdictional activities for the FPC to allocate to jurisdictional sales.

III

Petitioners' briefs present nothing which calls into question the foregoing demonstration that the decisions of the Fifth and Tenth Circuits are correct and consistent with the decisions of this Court. Petitioners' briefs, however, contain many contentions, which in certain instances are misleading, some of which we now consider.

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[18] 1963 gross revenues were $331,167,721. (FPC Form 2). The regulated revenues were $144,598,187, or 44%. 44% of the costs were allocated to regulated sales (Op 428, App. 7, CR 9158, 31 FPC 1217). The unregulated net profit is 56% of United's total profit.

1.

The FPC apparently contends that a consolidated tax is a joint cost (FPC 12-5). Memphis echoes (Memphis 13, 14-5, 16-7) and goes beyond, boldly asserting that the FPC was not required to separate the regulated from the unregulated but only required to show a fair action. In other words, that fairness, by some mysterious alchemy became warrant to ignore and trample the jurisdictional enclosure which Congress specified in the Act. Both cite *Colorado Interstate Gas Co.* v. *FPC* (1945) 324 US 581. But that case contains neither holding nor hint that "fairness", either abstractly or in connection with a formula disguised under the name of "allocation", constitutes authority to exercise power Congress did not grant. On the contrary, that case, (see p. 16-7, *infra*) rings the bell on the same character of action in which the FPC is engaged here.

Allocation, of course, is a useful tool for the FPC to use to separate that subject to its jurisdiction from that which is not, for identification of the jurisdictional is essential to the exercise of its regulatory authority expressly conferred by the Act. This, *Colorado Interstate* recognized, but it also cautioned:

> "When Congress, as here, fails to provide a formula for the Commission to follow, courts are not warranted in rejecting the one which the Commission employs *unless it plainly contravenes the statutory scheme of regulation.*" (p 589)

See, too, *Mississippi River Fuel Corp.* v. *FPC* (CADC 1947) 163 F 2d 433, 443. That "contravention" was precisely what the Fifth and Tenth Circuits determined occurred from the "devised method" which the FPC dubs "allocation."

Further, *Colorado Interstate,* assessing the fundamental purpose of judicial review under § 19(b), concluded:

"But that review is limited to keeping the Commission within the bounds which Congress has created." (p 589)

Again the Fifth and Tenth Circuits' decisions in express terms did just that.

The FPC expressly noted its obligation, in general, to separate in its decision here, declaring:

"We think it a desirable principle of rate making that costs should be directly assigned whenever feasible, and cost allocation with all of its complexities should be employed only when necessary. As witness for the Eastern Interveners testified, jurisdictional customers should not be burdened by the costs of nonjurisdictional purchases which are not subject to regulation by the Commission." (R II 48)

Narrowing to this *tax issue,* the FPC in *Cities Service,* conceded that such separation was mandatory (App C, 7c). The Tenth Circuit noted:

"The Commission recognized the fundamental ratemaking principle which requires a separation of regulated and nonregulated profits and losses in the determination of the tax allowance. And see Colorado Interstate Gas Co. v. F.P.C., 324 US 581; Panhandle Eastern Pipe Line Co. v. F.P.C., 324 US 635." (FPC App B, 34-5)

We have demonstrated that Federal income tax for every corporation is solely the function of its own separate taxable income times the statutory rate. We have also demonstrated that this separate and individual function is not disturbed but retained by the consolidated return statutes and regulations. Thus, the Tenth Circuit concluded:

"The uncontroverted facts show that the Gas Company not only incurred a tax liability during the repre-

sentative years at the statutory 52 percent rate, but its tax liability at that rate was reported to the parent Company, *and the consolidated returns actually reflect that tax liability.*" (FPC App B, 37).

The Court below adopted the Tenth Circuit decision as applicable to, and controlling of, United's tax situation here (R II 70-2).

Certain it is that the components determining Federal income tax status, have their genesis solely in the separate business operations of each member of the United affiliated group, and not from their joint use or operation of any facility or property. The taxable income of each member of such group derives alone from the revenues and expenses of each.[14] The resulting tax liability is, therefore, a direct cost of each. The one and only impact which a consolidated return has in this context is that it has effect to require full recoupment of all tax deductions and losses in the filing year instead of the eight year period of carry-backs and carry-forwards. If there is any excess of tax deductions and losses remaining, then and only then may, recourse be had to the carry-backs and carry-forwards.

Significantly, the FPC does not contend that there is anything "joint" until after the statutory recoupment has occurred. For not until then does its so-called allocation work appropriation of the non-jurisdictional oil losses which is the purpose of what both Circuits branded a "devised method." In other words, the end result of the consolidated return procedure suddenly becomes "joint" as attempted exculpation for the appropriations which the "devised method" works.

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[14] Of course, there can be joint costs which may constitute tax deductions, but such, when they occur, are always divided in some agreed equitable fashion.

But the so-called "allocation method — the three step procedure" (FPC 9) is just camouflage as we now expose. As shown, the FPC to define that which is subject to its regulation, must separate therefrom all operations, facilities and properties not subject to its regulation. So, to the FPC, "regulated" refers alone to its regulation.

Speaking of its so-called "three step procedure", it represents to this Court:

> "Under this method, any losses sustained by an *unregulated* company or activity *must first* be set off against the total income of all *unregulated* operations." (FPC 7)

Thus, in the quoted representation, as in the first step, "(1) separate the companies into regulated and unregulated groups", (R II 41), the FPC speaks in the context of "regulated" or "unregulated" under the Act. In truth, "regulated" can have no other term of reference.

Yet, this, the FPC completely disregarded. It says United was "largely" regulated (R II 41), but completely ignored United's unregulated area, and placed United, in its entirety, in the regulated group. Except for regulation of distribution operations by State Agencies, the FPC said Corporation was unregulated. But, Corporation was placed in the regulated group (R II 41-2). Union was regulated only as to its interstate sales of gas, but the FPC said since it was in a loss position, its classification as regulated or unregulated made no difference. Overseas, the FPC said, was in the non-regulated category.

The record, however, nowhere shows a separation into "regulated" or "unregulated" groups as the first step specifies. On the contrary, the record (R II 24 and 53) indicates that the first step was skipped and that the FPC netted all deductions and losses against all income as though all members of the group were wholly regulated.

Looking at its statutory jurisdiction, and its representations to this Court (FPC 7), it indisputably appears:

(1) Corporation was wholly unregulated by the FPC, so, it should have been placed in the unregulated group. Placing it in the regulated group was error and wholly beyond the FPC's authority.

(2) The FPC regulates only United's interstate business, which it admits (FPC 3), is but 44% of United's total business. The FPC does not regulate United's intra-state business. Thus, though the FPC wields no regulation over the greater part of United's business, it wrongfully placed it all in "regulated".

(3) Only about half of Union's business is subject to FPC regulation. Its intra-state gas business is unregulated. Its substantial oil business is unregulated. The FPC admits the record permitted separation of "Union's taxable income between its regulated and non-regulated business" (R II 42). This record clearly shows that Union's gas business for the "representative" period had a taxable income of $507,254, and that its oil operations resulted in a loss of $4,376,880, with Overseas having a loss in 1961 of $24,354 (App D; R II 24).

It is readily apparent from the foregoing that a separation into regulated and unregulated groups as step (1) specified, would place far greater income to "unregulated operations". Thus, its own so-called "three step procedure" clearly exposes how illegal and unauthorized is its attempted seizure of unrelated, non-utility, non-jurisdictional oil tax deductions and losses which belong, not to United, but to its affiliates Union and Overseas.

Summation of such "unregulated income", is unnecessary, for obviously the unregulated 56% of United's operations

would produce an amount in excess of Union's and Overseas' oil tax deductions and losses. (Cf fn 13, p 26, *infra*).

Finally, using the figures which the FPC advances (FPC 6), it is clear that the figure of $9,024,170 said to be Corporation's taxable income could easily take the $3,869,626 (App D), said to be Union's "net" tax losses. This would also have statutory consistency, for Corporation, it is, which pays the prejudicial price of Union's oil tax deductions and losses by reduction of its tax cost basis to the extent of Union's unrecouped deductions and losses. (Reg. §1.1502-34; 1.1502-35, App A 12-7a).

Hence, had the FPC followed its own "devised method", as to Step (1), and made the "set off" which it represents to this Court must *"first"* be done — "against the total income of all *unregulated operations*", Union's and Overseas' oil tax deductions and losses would have been utilized completely with nothing left against United's jurisdictional portion. Obviously the FPC knows all this.

The inevitable consequence of this is to show conclusively that as the Fifth Circuit held and United contends, its tax liability is determinable by its taxable income times the applicable statutory rate.

2.

Both briefs strain to erase the jurisdictional transgressions pointed out by the Fifth and Tenth Circuits. They attempt to suggest (FPC 10, part B, 14-5, 21, 23; Memphis 12, 18, 21) that United's jurisdictional customers contributed to Union's oil operations, always undocumented, ranging from the mere existence of United's taxable income at one end, to the claim, at the other end, that Union's oil exploration costs are included in the rates United pays Union for purchase price of gas. These inferences are specious.

In *Union's* case, 31 FPC 41, the FPC noted that "Union, like most producers, produces gas from some wells, oil from others, and joint products (gas and oil, or gas and condensate) from other wells" (p 48). It then approved the Examiner's joint-cost allocation which separated all joint costs between oil and gas including all exploration and development expenses (31 FPC 48-9; Examiner, 71-3, Appendix 6, Allocation of Exploration and Development costs, 83).

In that opinion it separated and determined a gas cost of service related only to gas plant and expenses required to discharge only interstate jurisdictional natural gas business. The allocation procedures had strained out all oil costs.

The FPC thereafter approved settlement rates, 32 FPC 1506, stating they were designed to recover the jurisdictional natural gas cost of service. Thus, Union's rate schedules on file with the FPC for sale of gas to United, are referrable to "jurisdictional" gas only. Such rates have all the status and legal force of filed rates.

Accordingly, we believe this Court will perceive, realities being what they are, that in *Union* the FPC by allocation separated and divided all costs and expenses between interstate gas (regulated by FPC) and oil (unregulated and non-jurisdictional) which prevented any inclusion of oil costs on gas. For the FPC is no stranger to the truism that the smaller the overall cost of service and the more the cost allocated to oil, the lower the gas rates. How conscious the FPC is of this, is shown by its statement on another contested issue, reserve for depreciation and depletion, "The larger the depreciation and depletion reserve, the smaller the rate base, *and the less the return.*" (31 FPC 44)

Memphis (Memphis 21) and the FPC (FPC 21) say that because Corporation's capital costs are applied to both Union and United, and because Union's business is risky, United's customers pay higher rates. This is but unsupported speculation. The fact is that Memphis agreed to the rate of return which is included in the settlement of United's case (R II 33). If Memphis had objections to the rate of return as influenced by capital cost, such objections should have been brought forward at the proper time for consideration by the FPC. Such objections may not now be used as a blunt instrument to do a job on the income tax component.

Moreover, the FPC nowhere in its opinion makes any findings or any mention of capital cost as a justification for its action on the tax question. In like situations, this Court has consistently held that administrative actions must and can only be sustained upon the bases claimed as justification by the agency itself *in its order*. In *Burlington Truck Lines, Inc.* v. *U. S.*, (1962) 371 U.S. 156, this Court stated:

> "The courts may not accept appellate counsel's post hoc rationalizations for Agency action; Chenery [332 U. S. 194, 196] requires that an agency's discretionary order be upheld, if at all, on the same basis articulated in the order by the agency itself." (p 168)

This unsupported assertion is therefore not only logically irrelevant but its consideration is legally out of place here.

3.

Memphis repeatedly cites *Mississippi River Fuel Corp.* v. *FPC*, (CADC 1957) 252 F 2d 619, cert den 355 US 904, as a basis to reiterate, as an incantation, that Union is United's "producing arm" (6, 12, 17, 20, 21). It does not disclose that during the period involved in *Mississippi* Union was not regulated by the FPC.

Further, it cites *Willmut Oil and Gas Co.* v. *FPC* (CADC 1962) 299 F 2d 111, without disclosing *Willmut* referred to the same period of non-regulation as *Mississippi*.

Considering this controlling fact of non-regulation, the D. C. Circuit in *Mississippi* followed the well-settled rule that where a regulated company acquires services from an unregulated affiliate, the regulatory agency is fully authorized to scrutinize such transaction to see that it is free from any abuse because of the affiliation. Regulation furnishes the sanction against any such abuse, and itself is the guaranty of its absence.

The District of Columbia Circuit confirms this. In *American Louisiana Pipe Line Co.* v. *FPC* (CADC 1965) 344 F 2d 525, American sold 95% of its gas to two affiliates (526). This compares with the 80% which the FPC says Union sells United (FPC 4). The issue was whether American should be permitted to have a "contract demand" type of rate or whether it should have a "cost of service form". The Court defines "contract demand" form as a rate that "fixes a set price for gas in dollars and cents per unit on the basis of experience in a test year" (526). The "cost of service" form "prescribes variable rates adjusted monthly so that a pipeline recovers its actual costs plus a fixed return." (526)

Union's sales to United are made at rates expressly approved by the FPC (*Union*, 32 FPC 1506).

In *American*, the FPC opposed a change from "cost of service" to "contract demand" rate for American and rejected an Examiner's decision approving a "contract demand" form of rate. The Court said:

> "It relied exclusively on the fact that American Louisiana sells virtually all of its gas to affiliates." (527)

In Footnote 12 (532), the Court said that the FPC cited *Mississippi* to support claim that its experience and expertise "justify its special treatment of inter-affiliate transactions", but the Court held *Mississippi* was "clearly distinguishable", for there "the inter-affiliate sale was *unregulated*" (italics by the Court). *Mississippi*, it noted, told the FPC that that sale "need be set aside only upon a showing of abuse." Where the rate was "regulated by the Commission, the problems considered in that case (*Mississippi*) would be far less critical."

In Dockets G-9547 *et al.*, the FPC denied United's motion to re-open the record to meet *Mississippi's* holding, an action which the FPC confessed in *Willmut*, was error. On that *Willmut*, footnote 1 (112) said:

> "It did reopen the record to include the rate schedules which Union filed after the Phillips case [Phillips Petroleum Co. v. State of Wisconsin] 347 U.S. 672, 74 S. Ct. 794, 98 L. Ed. 1035 was decided, *but those schedules were not determinative because they were not filed until after the hearings here involved were concluded.*"

Looking at the public policy which Congress embodied in § 4(a) and (b) of the Act, and the express approval by the FPC of the Union-United contract prices for Union's gas, it seems clear that their status as filed rates is not only within the provisions of § 4(c), but they have the legality and continuity proclaimed by *Montana-Dakota Util. Co.* v. *Northwestern Pub. Serv. Co.* (1951) 341 US 246, and *T.I.M.E., Inc.* v. *U. S.* (1959) 359 US 464 — subject to change only by a new filing under § 4(d), or an FPC direction pursuant to a § 5(a) review.

In view of these considerations, the prejudice attempted to be invoked here by "affiliation" is not only out of place, but of no influential impact.

Furthermore, if the United-Union contracts in their quantity specifications furnish Union "an assured market" (FPC 11) and "an assured source of substantial profits" (FPC 10), such also is the "assured" result of all of United's purchase contracts.

Under the FPC reasoning this would give United, and in turn any pipeline subject to FPC jurisdiction, entitlement to the tax deductions of each producer-vendor. Even the FPC would not so contend, but it is a fact that the same law which provides for the Union tax losses and deductions also provides that same "generous" allowance (FPC 11) to every producer even though he be not a member of an affiliated group filing a consolidated return. (Cf FPC discussion, R II 35-6; its Union decision, 31 FPC at 43, 47; and its order approving Union's settlement, 32 FPC 1506).

4.

The FPC (FPC 25-6) states that the basic purpose of the consolidated return is the "piercing" of the corporate veil. The legislative history, including those reports cited, carefully distinguishes between the business unit or entity on the one hand, and the separate corporate entity of the affiliate corporations on the other. The Courts clearly and without restriction hold that the consolidated return provisions of the Code and its accompanying regulations do not erode and destroy, but carefully preserve separate corporate entity. *Woolford Realty Co.* v. *Rose,* (1932) 286 US 319; *Founders General Corp* v. *Commissioner* (2 Cir 1935) 79 F 2d 6; *Felbro Corp.* v. *Commissioner* (1962) 36 T. C. 864, rev'd on other grounds (2 Cir. 1963) 315 F 2d 784; *Federal Export Corp.* v. *U. S.* (Ct. Cl. 1938) 25 F. S. 109; *Trinco Industries* (1954) 22 T. C. 959; *Olivier Co.* v. *Patterson* (1957) 151 F. S. 709; *Midland Management Co.* (1962) 38 T. C. 211. See, also, the FPC's own opinion in *Olin Gas Transmission Corp.* (1957) 17 FPC 685, 695.

As we read *Burnet* v. *Aluminum Goods Mfg. Co.*, (1932) 287 US 544 cited by FPC (FPC 26) it is not inconsistent with the separate entity theory of consolidated returns. The Court of Claims agrees with us, *Federal Export Corp.* v. *U. S.*, *supra*.

The indisputable truth is that the jurisdictional prohibitions which Congress imposed on the FPC have no relationship to corporate form or corporate business save only that business prescribed as within FPC jurisdiction by Section 1(b) of the Act.

5.

Memphis views with loud alarm the increase in "the cost of gas" to "over 100,000" of its customers if the Fifth Circuit be affirmed (Memphis 4). We test this, using the FPC Op 428 test period.

The annual cost effect of a reduction in Federal income tax rate from 52% to 50.04%, using the costs, allocation procedure, and cost allocation demand and commodity volumes per Op 428, App 6, (R II 54) is as follows:

	Annual Cost
Cost Reduction to all Central and Jackson Zone Transmission Customers	$262,471
Cost Reduction to Texas Gas Transmission Corporation[15]	35,988
Cost Reduction to Memphis based on 1963 Sales of Texas Gas Trans. Corp. (Texas Gas, Form 2)	6,082
Cost Reduction to Memphis Consumers based on 100,000 customers (Memphis 4)	6 cents

In our respectful submission, the facts clearly expose the Memphis claim to be without foundation.

[15] From whom Memphis secures its gas supply (Memphis 3).

CONCLUSION

For all of the foregoing reasons it is respectfully submitted that the decision of the Court below is right, and should be in all things affirmed, and it is so respectfully prayed.

Respectfully submitted,

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